

## **806 KAR 6:080. Reserve standards for individual health insurance policies.**

RELATES TO: KRS 304.6-070

STATUTORY AUTHORITY: KRS 304.2-110, 304.6-070

NECESSITY, FUNCTION, AND CONFORMITY: KRS 304.2-110 provides that the Executive Director of Insurance may make reasonable administrative regulations necessary for or as an aid to the effectuation of any provision of the Kentucky Insurance Code. KRS 304.6-070 provides that the Executive Director of Insurance shall issue administrative regulations establishing minimum standards for reserves for individual health insurance policies.

### **Section 1. Active Life Reserves. (1) General.**

(a) Active life reserves are required for all in-force policies and are in addition to any reserves required in connection with claims. For policy Types A, B, and C, described in subsection (2) of this section, the minimum reserve is determined as specified herein.

(b) It is emphasized, however, that these are minimum standards and that KRS 304.6-070 requires that higher, adequate reserves be established by the insurer in any case where experience indicates that these minimum standards do not place a sound value on the liabilities under the policy. For policy Type D, the minimum reserve should be the gross pro rata unearned premium (premium reserve).

#### **(2) Types of individual health insurance policies.**

(a) Type A - policies which are guaranteed renewable for life or to a specified age, such as sixty (60) or sixty-five (65), at guaranteed premium rates.

(b) Type B - policies which are guaranteed renewable for life or to a specified age, such as sixty (60) or sixty-five (65), but under which the insurer reserves the right to change the scale of premiums.

(c) Type C - policies in which the insurer has reserved the right to cancel or refuse for one (1) or more reasons, but has agreed implicitly or explicitly that, prior to a specified time or age, it will not cancel or decline renewal solely because of deterioration of health after issue; however, policies shall not be considered of this type if the insurer has reserved the right to refuse renewal provided the right is to be exercised at the same time for all policies in the same category, if premiums are graded so as to be substantially proportionate to the costs of insurance at the various attained ages. Policies which comply with KRS 304.17-275, on which premiums are based on issue age are of this type.

(d) Type D - all other individual policies.

(e) The above does not classify "franchise" as a type of policy. Such policies are frequently written under an agreement limiting the insurer's right to cancel or refuse renewal. Usually the right is reserved to refuse renewal of all policies in the group or other categories such as those ceasing to be members of the association, and this would place such policies in Type D in accordance with the last clause under paragraph (c) of this subsection. However, if premiums are based on the level premium principle in which any reflection of age is on the basis of age at issue, or if the renewal undertaking for the individual meets the requirements for Type A, B, or C, the franchise policy should be so classified for reserve purposes.

(f) A policy may have guarantees qualifying it as Type A, B, or C until a specified age or duration after which the guarantees, or lack of guarantees, may qualify it as Type A, B, C, or D. In such case, the policy in each period should be considered for reserve purposes according to the type to which it then belongs.

(g) Where all of the benefits of a policy, as provided by rider or otherwise, are not of the same Type (A, B, C, or D), each benefit should be considered for reserve purposes according to the type to which it belongs.

(3) Reserve standards for policies of Type A, B, or C.

(a) Interest. The maximum interest rate for reserves should be the greater of:

1. the maximum rate permitted by law in the valuation of currently issued life insurance, or
2. the maximum rate permitted by law in the valuation of life insurance issued on the same date as the health insurance.

(b) Mortality. The mortality assumptions used for reserves should be according to a table permitted by law in the valuation of life insurance issued on the same date as the health insurance.

(c) Morbidity or other contingency. Minimum standards with respect to morbidity are those stated in Appendix A of this administrative regulation, which is subject to revision from time to time with respect to dates of issue of contracts.

(d) Negative reserves. Negative reserves on any benefit may be offset against positive reserves for other benefits in the same policy, but the mean reserve on any policy should never be taken as less than one-half (1/2) the valuation net premium.

(e) Preliminary term. The minimum reserve shall be on the basis of two (2) years preliminary term.

(f) Reserve method. Mean reserves diminished by appropriate credit for valuation net deferred premiums. In no event, however, should the aggregate reserve for all policies valued on the mean reserve basis, diminished by any credit for deferred premiums, be less than the gross pro rata unearned premiums under such policies.

(g) Alternative valuation procedures and assumptions. Provided the reserve on all policies to which the method or basis is applied is not less in the aggregate than the amount determined according to the applicable standards specified above, an insurer may use any reasonable assumptions as to the interest rate, mortality rates, or the rates of morbidity or other contingency, and may introduce an assumption as to the voluntary termination of policies. Also, subject to the preceding condition, the insurer may employ methods other than the methods stated above in determining a sound value of its liabilities under such policies, including but not limited to the following:

1. The use of midterminal policy reserves in addition to either gross or net pro rata unearned premium reserves;
2. Optional use of either the level premium, the one (1) year preliminary term, or the two (2) year preliminary term method;
3. Prospective valuation on the basis of actual gross premiums with reasonable allowance for future expenses;
4. The use of approximations such as those involving age groupings, groupings of several years of issue, average amounts of indemnity;
5. The computation of the reserve for one (1) policy benefit as a percentage of, or by other relation to, the aggregate policy reserves, exclusive of the benefit or benefits so valued;
6. The use of a composite annual claim cost for all or any combination of the benefits included in the policies valued. For statement purposes the net reserve liability may be shown as the excess of the mean reserve over the amount of net unpaid and deferred premiums, or, regardless of the underlying method of calculation, it may be divided between the gross pro rata unearned premium reserve and a balancing item for the "policy reverse."

(h) Gross unearned preliminary term premium. Where a preliminary term method, either with a one (1) year or two (2) year preliminary term period, is employed, the gross pro rata unearned premium to be used in the comparison set forth in paragraph (f) of this subsection shall bear the same relationship to the net premium for the preliminary term period on the basis of the mortality, morbidity, and interest assumptions used for subsequent valuation as the gross premium charged bears to the net valuation premium used in subsequent years.

Section 2. Claim reserves, present value of amounts not yet due on claims (also called "Disabled Life Reserves" in the case of insurance providing loss-of-time benefits for disability due to accident

or sickness).

(1) General. Reserves are required for claims on all health insurance policies, whether of Type A, C, or D, providing benefits for continuing loss, such as loss of time or hospitalization.

(2) Claim reserve standards for total disability due to accident or sickness.

(a) Interest. The maximum interest rate for reserves should be the maximum rate permitted by law in the valuation of life insurance issued on the same date as the date the claim is incurred.

(b) Morbidity. Minimum standards with respect to morbidity are those stated in Appendix A of this administrative regulation, except that for unreported claims and resisted claims and, at the option of the insurer, claims with a duration of disablement option of the insurer, claims with a duration of disablement of less than two (2) years, reserves may be based on the individual insurer's experience or other assumptions designed to place a sound value on the liabilities. Reserves based on such experience or assumptions should be verified by the development of each year's claims over a sufficient period of years along the lines of Schedule O.

(c) For policies with an elimination period, the duration of disablement should be considered as dating from the time that benefits would have begun to accrue had there been no elimination period.

(d) A new disability connected directly or indirectly with a previous disability which had a duration of at least one (1) year and terminated within six (6) months of the new disability should be considered a continuation of the previous disability.

(3) Reserve standards for all other claim reserves.

(a) Interest. The maximum interest rate for reserves should be the maximum rate permitted by law in the valuation of life insurance issued on the same date as the date the claim is incurred.

(b) Morbidity or other contingency. The reserve should be based on the individual insurer's experience or other assumptions designed to place a sound value on the liabilities. The results should be verified by the development of each year's claims over a sufficient period of years along the lines of Schedule O.

(4) Valuation procedures. The insurer may employ suitable approximations and estimates, including but not limited to groupings and averages, in computing claim reserves.

Section 3. Severability. If any provision of this administrative regulation or the application thereof to any person or circumstance is for any reason held to be invalid, the remainder of the administrative regulation and the application of such provision to other persons or circumstances shall not be affected thereby.

Section 4. Effective Date. This administrative regulation shall become effective upon completion of its review pursuant to KRS Chapter 13A. (11 Ky.R. 681; eff. 11-13-84; TAm eff. 8-9-2007; TAm eff. 5-14-2008.)

APPENDIX A RESERVE STANDARDS FOR INDIVIDUAL HEALTH INSURANCE	
Minimum morbidity standards for valuation of individual health insurance policies are as follows:	
1. Total disability due to accident or sick- ness.	
	Active life reserves:
	Policies issued on or after January 1, 1965:

		The 1964 Commissioners Disability Table.
Claim reserves:		
	The minimum morbidity standard in effect for active life reserves on currently issued policies, as of the claim is incurred.	
2. Hospital benefits, surgical benefits, and maternity benefits (either specified or expense reimbursement).		
	Policies issued on or after January 1, 1955, and before January 1, 1982:	
	The 1956 Intercompany Hospital-surgical Tables.	
	Polices issued on or after January 1, 1982:	
	The 1974 Medical Expense Tables (Table A).	
3. Accidental death benefits.		
	Polices issued on or after January 1, 1965:	
	The 1959 Accidental Death Benefits Table.	
4. All other benefits, including major medical, cancer expense, and other than total disability.		
	The insurer should adopt a standard which will produce reserves that place a sound value on its liabilities under such benefit. The use of morbidity tables reflecting the insurer's own experience, with suitable margins for stochastic variation is encouraged.	